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***European Economic and Social Committee***

**TEN/605**

**Application of the Decision on public compensation for the provision
of services of general economic interest (2012/21/UE)**

**PRELIMINARY DRAFT OPINION**

Section for Transport, Energy, Infrastructure and the Information Society

**Application of the Decision on public compensation for the provision
of services of general economic interest (2012/21/UE)**
Own-initiative opinion

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| Study Group | Application of the Decision on public compensation for the provision of services of general economic interest (2012/21/UE) |
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# **Conclusions and recommendations**

## The European Economic and Social Committee (EESC) appreciates the implementation of the services of general economic interest (SGEIs) package, which brings legal certainty for public service providers. The package strikes the right balance between the need to foster and support SGEI and the objective of preventing potential distortions of competition. However, stakeholders at regional and local level, in particular publicly owned SGEI providers[[1]](#footnote-1), are voicing their concerns about key issues in the current rules that create unnecessary obstacles or a lack of legal certainty and therefore the EESC calls upon the Commission to take the measures needed to improve the current rules and their practical application, to provide guidelines, to create a best practices compendium and where necessary – to examine the need to update and amend the package.

## Reviewing the first two waves of Member States’ reports on the implementation of the SGEI package, the EESC notes with concern that they do not tackle the essential issue of compatibility requirements, a matter dealt with in depth by the Framework.

## The EESC notes that in most cases, the lack of certainty or the substantial costs involved in fulfilling the requirements raise barriers that unduly prevent authorities from fully implementing SGEI policy. Such hindrances acutely affect regional and local authorities, as the dialogue between the Member States and the Commission on State aid cases is undertaken by central government, while other administrative levels do not enjoy direct access to this process.

## The fact that only a handful of SGEI at regional or local level are reported[[2]](#footnote-2) shows that the lack of direct channels with the Commission hinders proper financing of public services, which makes the appropriate authorities more reluctant to make full use of the Decision and to clear up doubts regarding its implementation.

## The EESC calls on the European Commission to examine the possibilities of upgrading the Decision and of extending its scope, in order to address the following elements:

### The EESC suggests that the Commission remove the exemption threshold and include all SGEI in the Decision, regardless of the yearly compensatory amount. Careful study of its current implementation proves that this will reduce the administrative costs and complexities that authorities would otherwise face, in particular at local level, without distorting the competition in any way.

### In the light of the turbulent labour market and of challenging skills mismatches, the EESC calls on the Commission to examine the possibility of broadening the scope of the Decision, in order to link eligible services in order to enhance people's knowledge and qualifications and thus help them improve their job prospects.

### The EESC calls on the Commission to examine carefully and perhaps to amend the particular texts of the Decision, mainly related to: the time-limit for keeping records of all the information necessary to determine the compatibility of the compensation granted; clarifying that entrustments’ time limit should not have any material effect on their renewal or extension or on the eligibility of service providers running the remit; setting a readily available method for calculating reasonable profit; providing further clarification when addressing the requirement of sharing productive efficiency gains between the undertaking; ensuring a more flexible approach to minor overruns not exceeding 10% of the yearly average compensation exempting them from updating the parameters.

## The EESC finds that further clarification is needed of the conditions of compatibility under the Framework, related to:

## further specifying the alternative ways of meeting the requirement for ensuring compatibility in accordance with Article 106(2) of the Treaty on the Functioning of the European Union (TFEU) that are already widely used in its practice;

## avoiding mandatory requirements that might encroach on national law-making procedures, creating unwarranted problems;

## taking due account of the new legal requirements as regards procurement and concessions;

## coupling ex-ante methodology with full use of the ex-post net cost calculation, unless the authority prefers to set the compensation as a lump sum at the time of entrustment;

## endorsing both approaches for calculating the compensation - Net Aggregated Costs and Net Avoided Cost and provide further guidance on them in the Framework as it currently contains hardly any indication of how to establish the relevant counterfactuals;

## drawing a distinction between special or exclusive rights involving an advantage whose profit should be taken into consideration in financing public service obligations and universal coverage that involves a disadvantage for the designated provider;

## providing further clarification on profitability standards and to allow the use of different standards rather than imposing a particular one on the Member States;

## clarifying further the alternative ways of calculating these incentives, whose use should not be binding, given the complexity involved.

# **Subject of the own-initiative opinion**

## In its action plan for 2017, the EESC stressed the importance of services of general economic interest as an essential element of our European economic and social model, enshrined as such by Article 14 of the Treaty on the Functioning of the European Union.

## Article 14 calls on the Union and the Member States to *“take care that such services operate on the basis of principles and conditions, particularly* economic and financial conditions*, which* enable *them* *to fulfil their missions”*. Furthermore, it provides that *“* *the European Parliament* *and the Council, acting by means of* regulations *in accordance with the ordinary legislative procedure, shall establish these principles and set these conditions without prejudice to the competence of Member States, in compliance to the Treaties, to provide, to commission and to fund such services”*. This mandate has not been translated into specific legislative initiatives until now. By contrast, the European Commission has developed a far-reaching set of rules on State aid applicable to SGEIs following the case law of the Court of Justice of the European Union.

## The conditions of compatibility with the Treaty rules on State aid and Article 106(2) TFEU have been contentious, even since the Court of First Instance ruled in 1997[[3]](#footnote-3) that compensation awarded to firms implementing a public service mission should be regarded as State aid. Until then the consensus had been that compensating the extra costs stemming from the more demanding obligations associated with SGEIs did not confer any advantage. The Court of Justice reversed this position in 2001[[4]](#footnote-4), considering that the compensation could be considered State aid only if it exceeded the additional costs borne by the designated provider. Finally, the Altmark ruling in 2003[[5]](#footnote-5) established the criteria that any compensation scheme should meet to fall outside the scope of State aid rules.

## The European Commission determines the compatibility of SGEIs with State aid rules, closely following the three introductory Altmark criteria. This requires:

* a clear definition of the public service obligations and specific entrustment to the designated provider through a public act;
* *ex-ante* establishment of the parameters for calculating the compensation in an objective and transparent way;
* compensation not to exceed the expenses incurred in implementing the public service, taking into account the corresponding income and a reasonable profit;
* selection of the designated provider must be undertaken either:
* through a public procurement procedure ensuring the lowest cost for the community;
* determining the level of compensation on the basis of the costs that an average enterprise, well-run and adequately equipped, would bear in delivering the service, matched by the corresponding income, plus a reasonable profit.

## In 2005 the Commission adopted the "Monti-Kroes package", updated in 2011 (the "Almunia package"), with key rules for SGE funding: the package includes a Commission Communication[[6]](#footnote-6) (the “Framework” hereafter) setting out the conditions of compatibility for SGEIs and a Commission Decision[[7]](#footnote-7) exempting from notification schemes that are less likely to distort competition due to their limited funding[[8]](#footnote-8) or targeting of activities meeting social needs[[9]](#footnote-9). The Commission declared its intention to carry out a review of this set of rules five years after their entry into force.

## As part of its Programme for Europe, the EESC's objective with this own-initiative opinion is to contribute to the upcoming Commission review by taking a detailed look at experience with implementing the SGEIs package. To this end, the EESC has commissioned a study on the application of SGEIs rules to public compensation[[10]](#footnote-10).

## SGEI compensations rarely affect competition, as far as they cover the extra costs incurred by the designated providers in discharging the public remit. Thus, imposing on them the burden associated with State aid notification seems an overzealous step only justified in cases where other participants might suffer an undisputed damage. By contrast, conduct that severely undermines market conditions such as dumping sales from third countries or prices fixed at lower than warranted levels are unevenly matched by Community action. Thus, extending the scope of the Decision exempting SGEIs from notification, coupled with enhanced legal certainty and further flexibility in implementing the rules, seem essential to ensure that Treaty provisions fostering these essential services are properly met.

# **Upgrading the Decision and extending its scope**

## The EESC believes that the Decision strikes the right balance between the need to foster and support SGEIs and the objective of preventing potential distortions of competition. Exemption from notification reduces the administrative costs and complexities that authorities would otherwise face, in particular at local level. Because SGEIs that are not eligible under the Decision face stricter rules, only cases raising particular concerns for competition should fall outside its scope, in accordance with the aim of concentrating at EU level resources for the scrutiny of State aid. Experience has shown that the Commission clears an overwhelming majority of the SGEIs schemes examined by it. Only three SGEI cases have led to an in-depth investigation procedure under Article 108(2) of the TFEU since the 2012 Decision and Framework were enacted. Two cases involved postal services[[11]](#footnote-11) and another a hospital scheme[[12]](#footnote-12) following a Court ruling annulling a clearance decision by the Commission as the complexity meant that a formal investigation was required. In all cases examined by the Commission, claims by competitors play a key role, thus securing full discipline without requiring the systematic notification of SGEI schemes. Furthermore, case law and Commission practice provide enough guidance to stakeholders for gauging whether they can safely apply the Decision without the need to notify SGEIs schemes to secure full certainty. The EESC therefore suggests that the Commission remove the exemption threshold and include all SGEI, in the Decision regardless of the yearly compensatory amount, following the example of compensatory schemes for passenger transport[[13]](#footnote-13)..

## Setting a threshold according to the volume of aid involved thus triggering notification may have relevance for scrutiny at EU level, except in cases where granting the aid involves non-transparent modalities, such as fiscal rebates or exonerations, soft loans or public guarantees. Furthermore, the Decision provides that specific activities may require scrutiny due to competition concerns, thus allowing it to impose mandatory notification in order to address such cases. In any event, maintaining the current threshold set in Article 2(1)(a) of the Decision at such extremely low levels, imposes undue burden on authorities, with no visible advantage for enforcing competition. Therefore, the EESC would ask the Commission to confine the notification requirement to forms of aid or particular activities where potential distortions might warrant a closer view to ensure an even playing field.

## The EESC invites the EC to examine the possibility to broaden the scope of the Decision in order to make eligible services related to enhance people's knowledge and qualifications and thus improve their job opportunities. Furthermore, there is a need to provide clarification in grey areas involving private involvement, where further guidance would be welcome.

## The Decision should ensure full compatibility with higher-ranking Community law and avoid undue burden for regional and local authorities. In particular, Article 8 requires the Member States to keep available during the entrustment period and at least ten years from the end of that period all the information necessary to determine the compatibility of the compensation granted. This rule runs contrary to Article 17 of Council Regulation (EU) 2015/1589, which provides that on expiry of a 10-year period any aid granted becomes an existing measure, and thus fully compatible. Preserving information for more than 10 years[[14]](#footnote-14) that serves no purpose for State aid control represents an undue burden for authorities and infringes the principles of proportionality and proper administration enshrined in the Treaty.

## Article 2(2) of the Decision applies to entrustments awarded for a maximum of 10 years, except for those SGEIs requiring a significant investment justifying a longer period. While Commission practice under the Framework interprets this rule generally as preventing entrustments exceeding that time limit, the wording of the Decision could imply that undertakings running a public service for a longer period might fall outside its scope. The EESC therefore requests that the Commission clarify the entrustments' time limit should not have any material effect on their renewal or extension or on the eligibility of service providers running the remit. This issue is particularly sensitive in the case of publicly owned providers entrusted by their authorities, as their sole purpose is to provide the public service in question.

## Article 5(5), (7) and (8), concerning reasonable profit, should set a readily available method for calculating it. The current approach, similarly to that in the Framework includes methods such as the Internal Rate of Return that prove far too complex for local SGEI and thus discourage their use for calculating the compensation. Setting up profitability benchmarks involves costly consultancy services out of reach for most SGEIs. The EESC asks the Commission to clarify this issue, as Commission practice endorses the direct comparison with related sectors’ profitability based on available official or private data sources widely recognised as fully representative.

## Efficiency incentives , while lacking any definition, are taken into account in Article 5(6) thus requiring further clarification, in particular when addressing the requirement of sharing productive efficiency gains between the undertaking, the Member State and/or the users. The EESC asks the Commission to dispel any doubts about how to interpret this requirement.

## Article 6(2) of the Decision provides that any overcompensation should trigger an update of parameters for the future. Compensation not exceeding 10% of the yearly average amount can nevertheless be carried forward to the next period. Full consistency would argue for no updating of the parameters in the latter case, avoiding a reappraisal that would entail legal uncertainty for designated providers in cases that do not affect competition. The EESC recommends that the Commission ensure a more flexible approach to minor overruns not exceeding 10% of the yearly average compensation exempting them from updating the parameters.

## Any discriminatory treatment of local and regional authorities, and thus of the services of general economic interest provided at these levels, should be avoided. Currently, local and regional authorities have to submit their requests, answers and doubts through the official channel of their Member State, as only the latter can engage in a formal dialogue on State aid provisions with the Commission. Thus, the information issued by local and regional authorities for the attention of the Commission must be taken on board by the respective Member State. Therefore, the EESC invites the Commission to establish a more structured dialogue with local and regional authorities on State aid procedures and issues. State aid rules and requirements should also be adapted to the special needs and means available for regional and local authorities, thus ensuring fair and equal treatment in practice.

# **Clarifying the conditions of compatibility under the Framework**

## The Framework sets out in detail the different requirements for ensuring compatibility in accordance with Article 106(2) TFEU and the case law interpreting it. While it provides ample explanation of the criteria applied by the Commission, it often adopts an overcautious stance that creates unnecessary problems and produces a degree of uncertainty. Commission practice shows that in many areas such difficulties have been overcome by applying a pragmatic interpretation of the Framework. Making specific references to these solutions would increase legal certainty and effectively reinforce equal treatment while preserving the principle that each case should be examined on its merits. The EESC therefore recommends that the Commission further specify the alternative ways of meeting the requirement that are already widely used in its practice. Such clarification would dispel many of the doubts authorities and providers currently face.

## Under the Treaty, conferring and defining a public service remit fall under the fundamental competence of Member States, except in cases of manifest error. Thus the references in point 13 of the Framework to the conditions that SGIs/public services should meet can only serve as useful guidance. However, the inclusion of these references may raise legitimate concerns about a potential limitation of the Member States' powers. For, it is up to the Member States to decide, in the public interest, on the standards of “quality, safety, affordability, equal treatment, promotion of universal access and of user rights” that each essential service should meet, regardless of its coverage by the market or a remit. The Member States also have the power to decide accordingly whether ensuring those standards requires a SGEIs/public service. The market conditions, while being highly relevant, cannot overrule or curtail on the authorities' ability to defend the public interest. The EESC therefore suggests that the Commission limit its action here to a reference to its guiding Communication confining the scope of its assessment to checking the potential existence of manifest error, a matter ultimately falling within the remit of the Court of Justice.

## Point 14 of the Framework unduly places conditions on the powers of the Member States to grant a remit by requiring them to conduct public consultations to take into account the interests of users and providers, thus encroaching on national competencies that fall outside the Commission's purview. While authorities always pay due attention to stakeholders' interests, compelling them to justify the need for a remit and to conduct public consultations, or introducing alternative instruments, hardly fits with Treaty provisions and principles. The Commission's practice shows that it pays limited attention to this rule, especially if the Member States face hurdles in enforcing it. The EESC therefore proposes that the Commission redraft this point so as to avoid mandatory requirements that might encroach on national law-making procedures, creating unwarranted problems.

## The requirement under point 19 of the Framework that entrustments comply with Union public procurement rules fails to take into account that secondary law in this field has experienced a thorough review following the 2014 procurement package. The Public Procurement Directive only applies, according to its Article 1(2), to acquisitions by contracting authorities and cannot impose a binding regime on SGEIs as they refer to tasks performed by an undertaking on behalf of the authority. Thus, any requirement under procurement law would run contrary to its governing directive. The 2014 procurement package also rules concessions for the first time. But it would be highly misleading to infer that SGEIs could fall under this regime: concessions imply that undertakings assume all the risk once the award has been granted, in sharp contrast with SGEIs, where the authorities cover the extra costs involved in running the service, thus minimising risk. Only where the authority chooses to apply concessional treatment to an SGEI would this regime would apply, but in these cases there would be no aid element, as the designated provider would bear all risk. Thus, neither procurement nor concessional rules would apply to SGEIs. Legally speaking, the Framework can only call on the Member States to implement, where applicable, the principles of transparency and equal treatment for selecting providers, in particular private ones, with no binding obligation being attached to this request. The EESC therefore asks the Commission to revise point 19 of the Framework to take due account of the new legal requirements as regards procurement and concessions.

## While point 22 of the Framework provides that the compensation can be based either on expected or on actually incurred costs and revenues, all too frequently Commission practice requires establishing the compensatory amounts *ex ante*. Such a calculation method, which prevents authorities from compensating *ex post* according to the effective net cost, seems an undue interference that could lead to unsolvable problems, since if the *ex-ante* amounts fail to cover the net cost, the provider would face systematic underfunding. Moreover, if the authority provides additional support to bridge this gap, it would in principle face potential penalties for breaching the conditions set in the authorising decision. Commission practice has largely overlooked this inconsistency except in cases when a claimant has raised the issue. While it seems appropriate to set *ex ante* the methodology for calculating the compensation, the ensuing, tentative amounts should not have any binding character. Only once the yearly results are available can calculation of the net cost and corresponding compensation take place. The EESC therefore calls on the Commission to ensure full consistency and compliance with the second Altmark criterion by coupling *ex-ante* methodology with full use of *ex-post* net cost calculation, unless the authority prefers to set the compensation at the time of entrustment.

## The Net Avoided Cost method for calculating the compensation is based on the assumption that in the absence of a public service obligation the designated provider would downgrade its activities and aim to maximise revenues. The conventional NAC method would mean the provider discontinuing all loss-making activities. The difference between this counterfactual scenario and the actual results of the service provider determines the amount of the compensation. The Commission has recently advocated the Profitability Cost (PC) approach, where the counterfactual would be discontinuation of activities that prevent the undertaking from maximising its results. The compensation thus covers not only the additional costs of the SGEI but also the less efficient activities, even if they are profitable. To trim compensatory payments, the Commission requires the market and non-material advantages enjoyed by the provider to be deducted from the compensation. The preference for the PC approach leads to *de facto* divergences in implementing a single principle, thus compromising legal certainty. The EESC recommends that the Commission endorse both approaches and provide further guidance on them in the Framework, which currently contains hardly any indication of how to establish the relevant counterfactuals.

## The cost allocation method seems the most appropriate one for most SGEIs, as its calculation is based on the difference between the costs of meeting the public service obligation and the corresponding revenues. Nonetheless, the Member States wanting to use this method must justify the reasons for discarding the NAC approach that is otherwise considered mandatory. Since the NAC involves a complex and costly analysis, external consultancy services often being required, the EESC recommends that the Commission recognise this method as a fully valid one, on the same footing as the NAC except for specific activities such as postal services where such methodology stands as the binding one, according to the Third Postal Directive.

## Point 32 of the Framework, on revenue, rightly includes the excessive profits generated from special or exclusive rights. Yet in recent practice this has included profits from universal provision even if they do not derive from such rights, thus leading to misleading assessments. It should be stressed that universal coverage implies a disadvantage because the designated provider is bound to service a given territory regardless of the costs incurred. Thus, should the provider perform this service on a profitable basis, Treaty principles would be breached if this surplus should finance on a mandatory basis other loss-making public service obligations. The EESC therefore asks the Commission to clarify this point and to draw a distinction between special or exclusive rights involving an advantage whose profit should be taken into consideration in financing public service obligations and universal coverage that involves a disadvantage for the designated provider.

## Reasonable profit as envisaged in the Framework raises some issues that need further clarification. While the Framework advocates using Internal Rates of Return, it recognises the inherent difficulty of applying this method. Thus, in practice the Commission compares firms from the same or a related sector using standard profitability criteria such as ROE or ROS. Yet the lack of certainty on this issue often leads to divergent results. The EESC therefore suggests that the Commission recognise all standard and well-established profitability criteria rather than making any given one mandatory. The EESC asks the Commission to provide further clarification on profitability standards and to allow the use of different ones rather than imposing a particular one on the Member States.

## The mandatory efficiency requirement under points 39 to 46 of the Framework is proving to be a formidable hurdle for stakeholders and authorities alike. As the Framework provides no clue on how to calculate the efficiency incentives, Commission practice allows widely divergent assessments, thus compromising the principles of legal certainty and equal treatment. The EESC therefore asks the Commission to clarify further the alternative ways of calculating these incentives, whose use should not be binding given the complexity involved.

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1. Revealed by the Study “Review of Member States' reports on the implementation of the European Commission Decision on the provision of State aid to the provision of services of general economic interest”, commissioned by the TEN Section, April 2017. [↑](#footnote-ref-1)
2. According to the above study. [↑](#footnote-ref-2)
3. Ruling of 27 February 1997 in Case T-106/95 *Fédération Française des Sociétés d'Assurances (FFSA)*. [↑](#footnote-ref-3)
4. Ruling of 22 November 2001 in Case C-53/00 *Ferring SA*. [↑](#footnote-ref-4)
5. Ruling of 24 July 2003 in Case C-280/00 *Altmark*. [↑](#footnote-ref-5)
6. Communication from the Commission on the EU Framework for State aid in the form of public service compensation (2011). [OJ C 8, 11.1.2012, p. 15](http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2012:008:SOM:EN:HTML). [↑](#footnote-ref-6)
7. Commission Decision of 20 December 2011 on the application of Article 106(2) of the TFEU to State aid in the form of public service compensation to certain undertakings entrusted with the operation of SGEIs. [OJ L 7, 11.1.2012, p. 3](http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:007:SOM:EN:HTML). [↑](#footnote-ref-7)
8. Article 2(1)(a) of the Decision sets the annual threshold at EUR 15 million. [↑](#footnote-ref-8)
9. I.e. hospitals; health and long-term care; childcare; access and reintegration into the labour market; social housing; care and social inclusion of vulnerable groups; and maritime links to islands, airports and ports with a low volume of passengers. [↑](#footnote-ref-9)
10. "Review of Member States' reports on the implementation of the European Commission Decision on the provision of State aid to the provision of services of general economic interest", March 2017. The study analyses the national reports that following the Decision each Member State must submit every two years, providing a detailed overview of its application. The EESC study shows that while the Decision asks the Member States to provide in their reports an indication of potential difficulties or complaints stemming from application of the rules, this possibility has given rise to hardly any comment. Thus the scope of the study was enlarged to include postal service compensatory schemes, one of the main SGEIs subject to State aid funding rules. Passenger transport, the largest SGEI in terms of funding, falls outside the rules, being governed by specific provisions of the Treaty and a set of regulations. Public broadcasting, also a sizeable SGEI, has its own specific guidelines under the relevant protocol annexed to the Treaty. Energy is also an important sector. [↑](#footnote-ref-10)
11. State aid SA.35608 on Hellenic Post (ELTA), where the Commission opened a formal procedure raising doubts on the financing of the UPS compensation through a Fund financed by private operators; the case was closed after the Greek authorities withdrew their proposal.

 State aid SA.37977 on the Spanish Post Office, where the Commission opened a formal procedure for alleged aids granted in the period 2004-2010; the case is pending a final Decision. [↑](#footnote-ref-11)
12. Commission Decision on State aid SA.19864 on financing to IRIS hospitals in the Brussels Region. The case was cleared in 2009 but the Court of Justice annulled it in 2012 for failure by the Commission to carry out an in-depth investigation. The Commission opened the formal procedure in 2014 and reaffirmed the compatibility of the aid in the final Decision dated 5 July 2016. [↑](#footnote-ref-12)
13. Regulation (EC) No 1370/2007 of the European Parliament and of the Council of 23 October 2007 on public passenger transport services by rail and by road and repealing Council Regulations (EEC) Nos 1191/69 and 1107/70. [↑](#footnote-ref-13)
14. As the standard entrustment period runs up to 10 years, the Decision requires keeping records for 20 years, thus largely overcoming the latest 10-year period where such information might have relevance for State aid control purposes. [↑](#footnote-ref-14)